Supreme Court, U.S.
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IN THE

Supreme Court of the United States

October Term, 1966

Nos. 804

JOHN G. MOFFATT, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MARY E. MOFFATT, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

JOHN G. MOFFATT and MARY E. MOFFATT, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

FRANK E. NICHOL, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

RUTH H. NICHOL, *Petitioner,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

FRANK E. NICHOL and RUTH H. NICHOL, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

GEORGE G. MURRAY and ANNA MAE MURRAY, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Petition for a Writ of Ceritorari to the United States Court of Appeals for the Ninth Circuit.

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Petition for a Writ of Ceritorari to the United States Court of Appeals for the Ninth Circuit.

The petitioners pray that a writ of certiorari issue to review the judgments of the United States Court of

Appeals for the Ninth Circuit in the above-entitled actions.

OPINIONS BELOW.

The opinion of the Tax Court [I-R. 155, 203][1] is reported at 42 T.C. 558. The opinion of the Court of Appeals (App. B, p. 15) is reported at 363 F.2d 262 (9th Cir. 1966).

JURISDICTION.

The judgments of the Court of Appeals were entered on May 31, 1966. A petition for rehearing was denied on August 29, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED.

Whether the Court below, in construing the standard described by Internal Revenue Code (1954) Section 354(b)(1)(A) for the purpose of determining the existence of a "D" type corporate reorganization, could constitutionally promulgate alternate and inconsistent constructions of the applicable standard, the respective selection of which is made to depend upon whether the existence of a "reorganization" is urged by the Commissioner, on the one hand, or by the taxpayer, on the other.

Whether the Court below properly construed the standard described by the Internal Revenue Code (1954) Section 354(b)(1)(A) in its decision that a transfer of no more than 65 percent of the fair value

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[1] "I-R." refers to Volumes I and IA of the Transcript of Record printed for use in the Court of Appeals; "II-R." to Volumes II and IIA of that same Transcript; "App. A" and "App. B" to Appendices A and B, respectively, to this petition.

of assets of one corporation to another corporation constituted a transfer of "substantially all of the assets of the transferor" so as to result in a "reorganization" within the meaning of Internal Revenue Code (1954) Section 368(a)(1)(D).

STATUTES INVOLVED.

The pertinent statutory provisions are set forth in Appendix A, *infra.*

STATEMENT.

In both the Tax Court and the Court of Appeals, the petitioners took the position that the transactions in issue did not qualify as a "D" type reorganization under Sections 368(a)(1)(D) and 354(b)(1)(A) of the Internal Revenue Code of 1954 because: (1) they were not carried out pursuant to a plan of reorganization; (2) there was not an exchange of stock for stock; and (3) there was not a transfer by the transferor corporation of "substantially all" of its assets. The respondent, on the other hand, took the position that all three of these requirements had been satisfied and that a "D" reorganization had thus been effected, and the Tax Court so found. The Tax Court's decision was affirmed below by the Court of Appeals. While the petitioners do not now admit that there was either a plan of reorganization or a stock-for-stock exchange, they do concede these issues before this Court in order that this Court may direct itself solely to the most important legal questions set forth above. Thus, because of the petitioners' concession, these questions may be resolved by reference to undisputed facts found, for the most part in the Stipulation of Facts [I-R.. 112-

130] and the Exhibits thereto [Exs. 1-A to 38-LL], which facts are as follows:

Moffatt and Nichol, Inc. (hereinafter referred to as Inc.) was a California corporation organized in 1947 with its principal place of business in Long Beach, California. Inc.'s primary business was the practice of consulting engineering, but it was also licensed as a building contractor and from time to time had engaged in various joint ventures. The stock of Inc. was owned at all times by petitioners John G. Moffatt (45%), Frank E. Nichol (45%) and George G. Murray (10%). Those three stockholders, along with William J. Bobisch, a structural engineer employed by Inc., were the officers and directors of Inc. in October, 1957. [I-R. 113, 121; II-R. 124-126, 173.]

On July 22, 1957, a new entity, Moffatt & Nichol, Engineers (hereinafter referred to as Engineers) was incorporated under the laws of the State of California with authorized capital stock of 25,000 shares of $1 par value per share. In October, 1957, Engineers was authorized to issue its stock 40% to Moffatt, 40% to Nichol, 10% to Murray; and 10% to Bobisch. At that time, Bobisch subscribed and paid $2,500 for his 10% of the stock of Engineers.[2] In order to pay for the shares for which they had subscribed, Moffatt, Nichol and Murray borrowed a total amount of $22,500 from Inc. on their personal notes; thus payment in that amount was made by Inc. to Engineers on October 1, 1957. The obligations of Moffatt, Nichol and Murray on those notes to Inc. were discharged on December 23,

[2]On March 7, 1958, Bobisch terminated his employment with Engineers and sold his ten percent stock interest in equal parts to Moffatt and Nichol. [I-R. 129; Exs. 34-HH(1) and (2).]

1957, the date upon which the notes became due, by deductions against their salaries due from Inc.[3] Moffatt, Nichol, Murray and Bobisch became directors and officers of Engineers. [I-R. 114, 122, 125; Ex. 32-FF.]

As of October 1, 1957, Engineers took over all the employees of Inc. and commenced operations in the same leased premises. Inc. retained all of its existing contracts, most of which were not assignable, but Engineers, as Inc.'s agent, performed the remaining work under those contracts for which work it received reasonable compensation from Inc. All subsequent engineering contracts were entered into and performed by Engineers, which restricted its activities to consulting engineering. [I-R. 124-125; II-R. 30-39, 88; Exs. 30-DD, 39.]

On December 24, 1958, Moffatt loaned $27,000, Nichol $23,450, and Murray $13,000, a total of $63,450, out of their own cash funds, to Engineers in return for notes of that company. On that same date, Moffatt and Nichol also accepted notes of Engineers to cover salaries due to them by that company in the respective amounts of $6,611.45 and $5,747.91. [I-R. 129; Ex. 35-II.]

On December 23, 1959, Moffatt, Nichol and Murray again accepted notes of Engineers for salary indebtedness due to them by that company in the respective

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[3]Although the Tax Court found [I-R. 167] and the Court of Appeals stated (App. B, p. 10) that the notes were discharged by deductions from their salaries by Engineers, those courts were clearly mistaken. The undisputed evidence shows that such deductions were discharged against salaries due from Inc., the obligee on the notes. [I-R. 125; II-R. 46-48; Ex. 32-FF.]

amounts of $24,258.82, $24,258.82 and $7,382.36. [I-R. 129; II-R. 29-30; Ex. 35-II.]

The three notes totaling $63,450 which had been issued to the individuals by Engineers on December 24, 1958 in exchange for cash were partially satisfied by a cash payment of $8,000 in August, 1959, and by the issuance to them of 25,000 additional $1 par value shares of Engineers' stock in December, 1959. Thereafter, the remaining total balance on those notes was $30,450. [I-R. 125, 129; II-R. 48; Exs. 32-FF, 35-II.]

Beginning in October, 1957, Inc. also made loans to Engineers, and those loans totaled $89,000 by April, 1958, when the last of such loans was made. All of those loans were evidenced by short-term notes carrying interest at 5 percent. The interest was paid regularly, and principal payments totaling $33,000 had been made by the end of 1958. [I-R. 125, 129; Ex. 36-JJ.]

On December 23, 1958, the board of directors of Inc. adopted a resolution to wind up and dissolve that corporation. [I-R. 126.]

On December 30, 1958, Inc., pursuant to that plan of liquidation, distributed promissory notes of Engineers to Moffatt and Nichol, each receiving such notes in the amount of $20,000. Those notes were subsequenty turned in to Engineers in exchange for new promissory notes payable by Engineers to Moffatt and Nichol in the same amounts. Inc.'s distribution of those notes thereby reduced the balance of the amount owed to it by Engineers from $56,000 to $16,000. That $16,000 was paid to Inc. by Engineers on March 11, 1959. [I-R. 126-128; Exs. 33-GG, 36-JJ.]

On December 22, 1959, Inc. distributed, pursuant to the plan of liquidation, $60,000 cash to its stockholders. [I-R. 126, 128; Ex. 33-GG.]

On December 31, 1959, Inc. distributed, pursuant to the plan of liquidation, automobiles, office furniture and other equipment, having a total book value and fair market value of $10,169.93, to its stockholders. On January 2, 1960, the stockholders sold those same items, with the exception of one automobile which had been sold to an employee for $397.60, to Engineers for a total consideration of $9,772.33 which was not paid at that time but was credited to the Wardlow Property Account, a liability account owing from Engineers to Moffatt, Nichol and Murray. [I-R. 126, 128; Ex. 33-GG.]

On December 31, 1959, Inc. also distributed, pursuant to the plan of liquidation, the following properties to its stockholders [I-R. 127, 128; Ex. 33-GG]:

	Book Value	Fair Market Value
Net Accounts Receivable[4]	$ 1,979.33	$ 1,979.33
Earned but Unbilled Accounts Receivable	18,323.92	18,323.92
Land and Improvements (Including Building Plans)	75,444.34	84,995.85
	$95,747.59	$105,299.10

On January 2, 1960, the individuals transferred $18,799.17 of those net receivables to Engineers which credited the Wardlow Property Account in that amount. The receivables representing the difference of

[4]Accounts receivable in the amount of $20,292.78 and accounts payable in the amount of $18,313.45 were distributed. [I-R. 128; Ex. 33-GG.]

$1,504.08 were retained by the individuals and were never acquired by Engineers. [I-R. 128; Ex. 33-GG.]

On January 14, 1960, Inc. made its final distribution in liquidation to its stockholders with a cash distribution in the total amount of $24,083.64. The individuals then transferred that $24,083.64 to Engineers which amount was also credited to the Wardlow Property Account. [I-R. 128; Ex. 33-GG.]

As a result of the aforesaid transfers by the individuals to Engineers on January 2 and 14, 1960, the Wardlow Property Account owed to the three individual stockholders was credited in the total amount of $52,655.14. Engineers satisfied its liability under that account in the following manner [I-R. 128; Ex. 33-GG]:

Date	Transaction	Amount
3-14-60	Check issued to California Franchise Tax Board	$ 100.00
4-14-60	Check issued to Frank E. Nichol	18,600.00
4-14-60	Check issued to John G. Moffatt	19,100.00
12-31-60	Offset to accounts receivable from John G. Moffatt	2,561.32
12-31-60	Offset to accounts receivable from Frank E. Nichol	3,751.44
8-23-61	Check issued to joint account, Moffatt, Nichol, Murray (Wardlow Property)	8,542.38
		$52,655.14

It is undisputed that of the total net assets distributed in the liquidation of Inc., $239,552.67, the land and building plans with a fair market value of $84,995.55 (which represented 35.48 percent of that total)

were retained by the stockholders and never transferred to Engineers; thus, at most, only 64.52 percent of the net assets could have been transferred to Engineers. [I-R. 200-201; App. B, p. 15.]

On the basis of the above facts, the Tax Court held that, under Section 354(b)(1)(A) of the Internal Revenue Code of 1954, "substantially all" of the assets of Inc. had been transferred to Engineers and that the total distributions in liquidation were "boot" incident to a corporate reorganization described in Section 368(a)(1)(D) of that Code which were taxable in full as ordinary income under Section 356 of that same Code.

The Court of Appeals for the Ninth Circuit affirmed the Tax Court. In so holding, the Appellate Court attempted to distinguish its decision below from its own prior decision in *Pillar Rock Paving Co. v. Commissioner of Internal Revenue,* 90 F.2d 949 (9th Cir. 1937) wherein, because of the peculiar circumstances of the taxpayer, the taxpayer unsuccessfully relied upon the identical construction of the phrase "substantially all" successfully urged by the Commissioner below. In negating petitioner's contention that the court's decision in *Pillar Rock, supra,* compelled use of a similar construction below, the Court of Appeals distinguished the former case by the explanation (App. B, p. 16, fn. 1) that there "the *taxpayer* had to show a 'transfer of substantially all' assets in order to *avoid* tax."

REASONS FOR GRANTING THE WRIT.

The fundamental importance of this case lies not only in the economic and revenue implications of the Appellate Court's peculiar characterization of the transaction in issue, but also in the Constitutional ramifications of the rationale used by that Court in arriving at that characterization.

It is the reorganization sections of the Revenue laws which are in issue. Those sections were recently considered by this Court in *Turnbow v. Commissioner*, 368 U.S. 337 (1961), where it was argued that a reorganization should be found to exist regardless of a failure to comply with the reorganization statute there relevant. The theory in *Turnbow* (as here) was that there "would have been" a reorganization but for the lack of fulfillment of certain literal statutory conditions. In rejecting that "would have been" approach, this Court stated (at 343):

> But we cannot agree that § 112(c)(1) authorizes the assumption, contrary to the actual facts, of a "reorganization," as defined in § 112(g)(1)(B) and used in § 112(b)(3). To indulge such an assumption would actually be to permit the negation of Congress' carefully composed definition and use of "reorganization" in those subsections * * *

It is those "carefully composed" definitions in the reorganization provisions of the Revenue laws upon which the members of the business community must necessarily rely in planning their transactions[5] and

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[5]See, *e.g.*, Sapienza, *Tax Considerations in Corporate Reorganizations and Mergers*, 60 NW. U.L. REV. 765 (1966) wherein the author comments (at 765) upon the importance of the consideration of the impact of the reorganization pro-

upon which the Commissioner of Internal Revenue must likewise reply in administering those laws.[6] The decisions of the courts below are in conflict with legislative intent and prior, long-standing judicial decisions and administrative interpretations. As a result of their interpreting the "carefully composed" statutory language in issue contrary to its plain, ordinary meaning, these decisions will create serious confusion in this important area of the revenue laws where reliance on such a meaning is essential to all parties, and will afford an opportunity for unequal treatment among taxpayers according to the whims of the Commissioner and the courts. Additionally, in construing the statute the Court of Appeals below applied a method of construction which, if correct, would result in an unconstitutional deprivation of due process. It is for these reasons that we believe this Court should grant a writ of certiorari in these actions. For the reasons hereinafter set forth in support of the foregoing, the courts below were manifestly in error in holding for the respondent.

1. Since 1924 it has been the law that no gain or loss is recognized by a corporation upon its liquidation and that its shareholders will recognize capital gain or loss measured by the value of the assets received in liquidation less the basis for their shares.[7] It is now

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visions by the business community in ordering their financial affairs and The Wall Street Journal, Oct. 12, 1966, p. 1, col. 5, quoted *infra*, p. 23.

[6]See, *e.g.*, Rev. Proc. 66-34, 1966 Int. Rev. Bull. No. 34, at 22, wherein the Commissioner sets forth the operating rules under which favorable tax rulings will be issued to taxpayers with respect to proposed reorganizations.

[7]Revenue Act of 1924, ch. 234, § 201-203, 43 Stat. 254. These same principles are now set forth in § 331, 336 and 1001 of the Internal Revenue Code of 1954.

and consistently has been the petitioners' position that the liquidation of Inc. is subject to those legal principles which thus required them to report the gains realized as a result of the liquidation of Inc. as capital gains. The respondent, on the other hand, has taken the position and the courts below have held that the organization of Engineers and the liquidation of Inc., which began approximately eighteen months later, constituted a single transaction which was a "D" reorganization under Sections 368(a)(1)D) and 354(b)(1)-(A) of the Internal Revenue Code of 1954[8] which thus required the petitioners to report their gains as dividends pursuant to Section 356(a).

2. Section 354(a) in effect provides that no gain or loss will be recognized if stock or securities of a corporation which is a party to a reorganization are received pursuant to the plan of reorganization, but Section 356(a) provides further that where property or money is received in addition to the stock or securities such property or money shall be treated as a dividend. Section 368(a)(1) exclusively delineates those transactions which will qualify as reorganizations and includes the following:

> (D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in conrtol of the corporation to which the assets are transferred: but only if, in pursuance of the plan, stock or securities of

[8]All further section references herein will be to the Internal Revenue Code of 1954 unless otherwise specified.

the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355 or 356.

In turn, Section 354(b) provides in pertinent part:

(b) EXCEPTIONS

(1) IN GENERAL. — Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless —

(A) the corporation to which the assets are transferred *acquires substantially all of the assets of the transferor of such assets;* and

(B) the stock, securities and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization. [Emphasis added.]

We submit that the quoted provisions do not apply in the instant actions for the simple reason that Engineers never acquired, directly or indirectly, "substantially all of the assets" of Inc. While that phrase or the similar phrase "substantially all the properties"[9] has been

[9]The phrase "substantially all the properties" is presently found in Section 368(a)(1)(C) which defines the so-called "C" reorganization. Even though the phrases differ in that 368(a)(1)(C) uses the word "properties" whereas 368(a)(1)(D) in conjunction with 354(b)(1)(A) uses the word "assets", it is apparent that both phrases have the same meaning, for Congress has used those two words interchangeably. See S. Rep. 1622, 83d. Cong., 2d Sess., 265, 273-275 (3 U.S.C., Cong. & Adm. News (1954) 4629, 4903, 4912-4913). These same words are also used interchangeably in Treasury Regulations on Income Tax (1954 Code) § 1.354-1(a) and in I.T. 2373, VI-2 Cum. Bull. 19 (1927), Rev. Rul. 57-518, 1957-2 Cum. Bull. 253, and Rev. Proc. 66-34, *supra.* Therefore, the decisions in cases involving the similar term in "C" reorganizations are clearly in point in cases involving the words "substantially all" in "D" reorganizations.

in the revenue laws since 1921[10] Congress has never codified the term in those laws, nor have the Treasury Regulations set forth such a definition. Nevertheless, legislative history, the judicial decisions, and the Commissioner's own rulings indicate quite clearly that the acquisition of less than 80 percent of all the assets does not constitute "substantially all."

3. Prior to the Tax and Appellate Court decisions in this action, the courts had consistently refused to characterize a transfer of less than 80 percent of the net assets as a transfer of "substantially all" of a corporation's properties. *Pillar Rock Paving Co. v. Commissioner,* 90 F.2d 949 (9th Cir. 1937); *C. T. Inv. Co. v. Commissioner,* 88 F.2d 582 (8th Cir. 1937); *Arctic Ice Machine Co.,* 23 B.T.A. 1223 (1931) *modified per curiam pursuant to stipulation,* 67 F.2d 983 (6th Cir. 1933); *Richard K. Mellon,* 12 T.C. 90 (1949), *affirmed on other issues,* 184 F.2d 157 (3rd Cir. 1950); *Edward H. Russell,* 40 T.C. 810 (1963), *affirmed per curiam,* 345 F.2d 534 (5th Cir. 1965); *National Bank of Commerce of Norfolk v. United States,* 158 F.Supp. 887 (E.D.Va. 1958).[11]

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[10]Revenue Act of 1921, ch. 136, § 202(c)(2), 42 Stat. 230. The progressive legislative changes in Subsection 202(c)(2), which are traced in SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS 1938-1861 (1938) at 789-797, clearly demonstrate that the words "substantially all" were intended to mean "nearly all", a term which must necessarily be proximate to totality.

[11]Not only have the cases held that the words "substantially all" in the reorganization sections mean just what they say—a transfer of all but a minor part of the assets—but they have held similarly where the same words have been used with respect to the excess profits tax and the tax on life insurance premiums. *Dixie Portland Flour Co.,* 31 T.C. 641 (1958); *Frederick A. Duddérar,* 44 T.C. 632 (1965); *acq.* 1966 Int. Rev. Bull. No. 36, at 7. These words have been

Prior to the Appellate Court decision in this case, the standard posed by the requirement that "substantially all" the assets be transferred was uniformly applied regardless of whether "reorganization status" was sought by the Commissioner or by the taxpayer. This principle is best evidenced by reference to *Pillar Rock Paving Co. v. Commissioner, supra,* wherein under facts analogous to those of the present case, the Court of Appeals for the Ninth Circuit rejected the taxpayer's contention that it had accomplished a "reorganization." Upholding the Commissioner, that decision held that the transfer of approximately 68 percent of the fair market value of assets did not constitute "substantially all", even though the only assets retained were accounts receivable. The opinion stated in part (at 950):

> The first question is: Did petitioner convey "substantially all" of its "properties"? Substantially the same language was used in the Revenue Acts of 1921, 1924, and 1926. Here, petitioner transferred assets costing $60,536.06 receiving therefor $94,591.50. It retained as assets, only accounts receivable in the sum of $45,294.52. Using cost as a basis, petitioner transferred approximately 57 per cent. of its assets, and using value received as a basis, petitioner transferred approximately 68 per cent. of its assets.
>
> Petitioner contends that substantially all of its "properties" means substantially all its physical "operating" properties. We believe no such limitation can be placed on the word "properties". The word must be taken in its ordinary sense, and as

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construed to mean "* * * all but what should be disregarded under the *de minimus* rule." *Blue Ridge Lumber Products Co. v. Nelson,* 213 F.2d 451, 453 (2nd Cir. 1954).

> it is a comprehensive word, it includes accounts receivable. If Congress had intended to restrict the meaning of the word, it would have done so.
>
> * * * * *
>
> . . . Considering it most favorably to petitioner, 68 per cent. is not "substantially all" its properties. It kept about one-third of its properties.

While the Tax Court below quoted and relied upon isolated passages from decisions in various cases [I-R. 194-203], none of those cases held that "substantially all" of the assets were acquired where less than 80 percent of the net assets were transferred. In most of those cases, the percentages transferred were much higher than 80 percent.

In its decision, the Court below acknowledged the above indicated principles and their applicability to petitioners. In this respect, the Court of Appeals said (App. B, p. 15):

> The taxpayers in the present case strenously contend that not substantially all of Inc.'s assets were transferred to Engineers, and a 368(a)(1)-(D) reorganization therefore did not occur. The taxpayers rely primarily on the fact that a large portion of the book assets of Inc. (35.48%) was in the form of land investment and building plans (held for a proposed building construction) which never came into the ownership of Engineers. We find substance to taxpayers' contention when we apply a straight percentage of book assets test to determine what constitutes "substantially all." *Commissioner v. First Nat'l Bank,* 104 F. 2d 865 (3d Cir. 1939), is frequently cited for the proposi-

> tion that 86 per cent total net worth is "substantially all." *Arctic Ice Machine Co. v. Commissioner,* 23 B.T.A. 1223 (1931), similarly is cited for the proposition that 68 per cent is insufficient.

Having so acknowledged the validity of petitioners' contentions, the Court then went on to disapprove petitioners' authority by stating:

> We are of the opinion, however, that a sounder view is espoused by Rev. Rul. 57-518, 1957-2 C.B. 253, to the effect that no particular or specific percentage should be controlling.[1] Rather, the ruling advises that "the nature of the properties retained by the transferor, the purpose of retention, and the amount thereof" are all to be considered.

The Court of Appeals thus served notice that it intended to jettison the more restrictive and authoritative standard, at least in cases in which "reorganization" was urged by the Commissioner, in favor of a "flexible" rule more attuned to recognition of the tax consequences sought to be avoided by the taxpayer.

The Court of Appeals, however, in its footnote 1 in the previous quotation, sought to preserve the viability of its own authority in *Pillar Rock, supra,* which might otherwise have been deemed overruled because of its insistence that "when the statute says 'substantially all' it means what it says," *Id.* at 950, and that "If Congress intended to limit the transfer to 'operative assets' it would have said so. . . . Congress did not, and the Court should not read into the Code that which is not there." *Id.* at 950. In the same footnote, the Appellate Court sought to explain the continued viabil-

ity of *Pillar Rock, supra,* with the following constitutionally questionable rationale (App. B, p. 16, fn. 1):

> Neither *Pillar Rock Paving Co. v. Commissioner of Internal Revenue,* 90 F.2d 949 (9th Cir. 1937), nor *C. T. Inv. Co. v. Commissioner of Internal Revenue,* 88 F.2d 582 (8th Cir. 1937), compel a different result. . . . Both cases involved a situation where the *taxpayer* had to show a "transfer of substantially all" assets in order to *avoid* tax.

The Court of Appeals, by its decision below and by its simultaneous approval therein of its own prior holding in *Pillar Rock* has deliberately promulgated alternate and inconsistent constructions of the statutory standard "substantially all." These inconsistent constructions, the "straight percentage" rule enunciated by the Court in *Pillar Rock, supra,* and the "flexible" rule adopted and relied on by the Court in the decision below, were expressly distinguished solely upon the identity of the party, whether Commissioner or taxpayer, urging the existence of a reorganization.

No authority need be cited for the universally recognized legal axiom that a statute cannot be applied according to two different standards depending upon whether it is asserted for or against a particular party or parties similarly situated. See, *e.g., Healy v. Commissioner,* 345 U.S. 278, 284-285 (1952). This maxim is equally as appropriate in revenue administration as in the law generally, and it loses no validity merely because the taxpayer is more interested in tax avoidance than in tax collection. See *Gregory v. Helvering,* 293 U.S. 465 (1935).

The "*impersonal, equal,* and *certain* administration of justice so far as these may be served by means of

precepts of *general* application" has been deemed to be the essence of "Justice according to law." See 2 *Pound, Jurisprudence* 374 (1st ed. 1959). Violation of this precept, by a court's simultaneous and discriminatory recognition of various constructional standards for particular parties, constitutes a deprivation of liberty of access to the protection of a federal statute without due process of law, in contravention of *U. S. Const.* amend. V.

Contrary to the assertion of the Court below, such a unilateral application of the protection of a revenue statute cannot be supported by the authority cited below, *Pridemark, Inc. v. Commissioner of Internal Revenue,* 345 F.2d 35 (4th Cir. 1965), where (at 44) it was said that since "capital gain provisions are an exception to the ordinary treatment accorded most income, they must be strictly construed." The fact that capital gain definitions present exceptions to the normal rule which requires resolution of doubts against the Government and in favor of the citizen,[12] is irrelevant to the present issue. Justice dictates that a particular statute, whether construed strictly or leniently, be construed *uniformly* regardless of the identity of the party asserting its applicability.

4. The only authority which the appellate court below cited in holding for the Respondent was Rev. Rul. 57-518, 1957-2 Cum. Bull. 253. That Ruling held that where a corporation transfers 70 percent of its assets, such a transfer constitutes "substantially all" of the properties if the properties retained are approximately equal in value to the amount of the liabilities. In so holding, the Commissioner not only withdrew his non-

[12]See *Gould v. Gould,* 245 U.S. 151 (1917).

acquiescence in the case of *Milton Smith,* 34 B.T.A. 702 (1936), and acquiesced in that case, but also relied solely upon that case as the authority for the Ruling.

In the *Smith* case, after favorably citing several cases, including *Pillar Rock Paving Co. v. Commissioner, supra,* which cases had held that, where transfers of 80 percent or less of the properties had been made, such transfers were not transfers of "substantially all" the properties, the Court said (at 706):

> All of these cases are distinguishable from the one before us. *In each of them there was retained a substantial amount of assets in proportion to the assets transferred and in none was the retention for the sole purpose of liquidating liabilities.* In this case, as above pointed out, assets having a book value, in round figures, of $133,000 were transferred for stock worth $170,000; assets worth $52,000 (including the doubtful real estate) were retained for the purpose of meeting liabilities of $46,000. After discharging its liabilities—and this was done within the year—the outside figure of assets remaining with the petitioner would be $6,000, *which is certainly not an excessive margin to allow for the collection of receivables with which to meet its liabilities. No assets were retained for the purpose of engaging in any business or for distribution to stockholders. In these circumstances,* we are of the opinion that the assets worth $133,374.08 transferred to the Shaver Co. constituted "substantially all" the assets of the Smith Co. within the meaning of that statutory phrase and the transaction is non-taxable under section 112(i)(1)(A). * * * [Emphasis added.]

In relying on the *Smith* case, the Commissioner said in Rev. Rul. 57-518 (at 254):

> The instant case, of the assets not transferred to the corporation, no portion was retained by M corporation for its own continued use inasmuch as the plan of reorganization contemplated M's liquidation. Furthermore, *the assets retained were for the purpose of meeting liabilities, and these assets at fair market values, approximately equalled the amount of such liabilities.* Thus, the facts of this case *meet the requirements established in the case of Milton Smith, supra.* [Emphasis added.]

Rev. Rul. 57-518 also specifically reaffirmed that portion of IT. 2373, VI-2 Cum. Bull. 19 (1927), which had held that, where a corporation transferred its manufacturing plants, consisting of land, buildings and equipment, and which approximateed 75 percent of its assets, and retained only about 25 percent of its assets, consisting mostly of accounts receivable and a contract right to receive stock, that corporation had *not* transferred "substantially all" its assets.

In the instant case, the shareholders of Inc. admittedly received and retained *at least* 35 percent of the *net* assets; thus under the authority of Rev. Rul. 57-518, I.T. 2373, and the *Smith* case there could not have been a transfer of "substantially all" the assets to Engineers under these circumstances.

While the Commissioner, of course, does not have general authority to define, as matters of law, the provisions of the Revenue laws, he is responsible for in-

terpreting and administering those laws in a non-discriminatory manner at the executive level and his duties include the issuance of Revenue Rulings. Section 7805, Internal Revenue Code of 1954; Treasury Regulations on Procedure and Administration (1954 Code), Section 301.7805-1. Pursuant to that authority, on August 22, 1966, the Commissioner issued Revenue Procedure 66-34,[13] 1966 Int. Rev. Bull. No. 34, at 22, where the Commissioner sets forth the operating rules under which favorable tax rulings will be issued to taxpayers with respect to proposed reorganizations. In Section 3 of that Revenue Procedure the Commissioner has continued to take the position, which he first took in I.T. 2373, *supra,* that at least 70 percent of the *gross* assets of a corporation, must be transferred, as well as at least 90 percent of the *net* assets, in order to qualify as a transfer of "substantially all" the assets. Thus, Section 3.01 of Revenue Procedure 66-34 provides (at 22):

> The "substantially all" requirement of sections 354(b)(1)(A), 368(a)(1)(C) and 368(a)(2)-(B)(i) of the Code is satisfied if there is a transfer of assets representing at least 90 percent of the fair market value of the net assets *and* at least 70 percent of the fair market value of the gross assets held by the corporation immediately prior to the transfer. [Emphasis added.]

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[13]The Petition for Rehearing herein was denied by the Court of Appeals before the petitioners had an opportunity to call this ruling to that Court's attention.

The extreme importance of Revenue Procedure 66-34 was recognized in the comments thereon in The Wall Street Journal, October 12, 1966 wherein it was stated (p. 1, col. 5):

> CORPORATE REORGANIZATION *standards should help speed transactions.*
>
> That's the word from practitioners on the new IRS statement of conditions under which it will say in advance whether a proposed merger or other corporate change is tax free. The Service issues several hundred of such advance rulings a year, but private tax men have never been sure whether or not it would approve a particular arrangement.
>
> Now the Service has put in writing certain standards which, practitioners say, it previously applied as informal "rules of thumb." For example, the code provides that an acquisition of one company by another is tax free to stockholders of the acquired concern if "substantially all" of the assets are taken over. The Service now specifies it will consider this requirement has been complied with if at least 90% of the net assets and 70% of the gross assets are transferred.
>
> *"The new procedure clears the air," says a New York tax accountant. "It should be easier now to devise terms that will be acceptable to the service the first time."*

It is patent that the petitioners would not have been able to obtain a favorable ruling under Rev. Proc. 66-34 that a "D" reorganization had been effected, for the transfer in issue failed the 90 and 70 percent tests set forth in that ruling. Yet the courts below have allowed the Commissioner to take a discriminatory posi-

tion herein which is inconsistent with that ruling as well as with the previously-cited rulings. The refusal of the courts below to follow what is necessarily a quantitative test will result in situations where, even though a taxpayer has fallen within or without the published administratively permissible boundaries of a "C" or "D" reorganization, it will not be able to determine the applicability of those sections, and the Commissioner will be thus able to withhold administrative relief at his whim. Such a result will, contrary to the purported and certainly desirable purpose of Revenue Procedure 66-34, create a chaotic uncertainty in the field of corporate reorganizations where assurance of tax consequences are of absolute necessity for the taxpayers and should be equally so for the Commissioner.

5. While the term "substantially all" can be traced back to the Revenue Act of 1921 with respect to a "C" type reorganization, a "D" type reorganization was not limited by such a term prior to passage of the Internal Revenue Code of 1954. Section 112(g)(1)(D) of the Internal Revenue Code of 1939,[14] which was the predecessor of present Section 368(a)(1)(D), provided:

> * * * (D) a transfer by a corporation of *all or a part of its assets* to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, * * * (Emphasis added.)

Thus, present Section 368(a)(1)(D) differs materially from its predecessor in the Internal Revenue Code of 1939.

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[14]As amended by §213 of the Revenue Act of 1939, ch. 247, 53 Stat. 870.

The House-passed version of the Internal Revenue Code of 1954, H. R. 8300, 83rd Cong., 2d Sess. (1954), provided for several changes in the reorganization provisions of the 1939 Code. In that House version, new Section 357 was proposed to deal with a liquidation-reorganization, while reorganizations themselves, were defined by proposed Section 359; thus, Subsection 359-(b) incorporated the "B" type reorganization into the new Code; Subsection 359(c) incorporated the "C" type reorganization; and Subsection 359(d) incorporated the "D" type reorganization. Section 357 of that bill was stated to be "* * * a specific provision designed to make impossible the withdrawal of corporate earnings at capital-gains rates through the device of liquidating the corporation and reincorporating the business assets, a device which has been sanctioned by certain courts under existing law." H. Rep. No. 1337, 83rd Cong., 2d Sess. 40 (3 U.S.C., Cong. and Adm. News (1954) 4025, 4066).

Section 357 of the House bill was deleted in the Senate and did not appear in the final bill. With respect to this deletion, H. Conference Rep. No. 2543, 83rd Cong., 2d Sess. (3 U.S.C., Cong. & Adm. News (1954) 5280) states, in pertinent part, as follows (at 41):

> (i) *Liquidation followed by reincorporation.*—The House bill in section 357 contained a provision dealing with a device whereby it has been attempted to withdraw corporate earnings at capital gains rates by distributing all the assets of a corporation in complete liquidation and promptly reincorporating the business assets. This provision gave rise to certain technical problems and it has

> not been retained in the bill as recommended by the accompanying conference report. It is the belief of the managers on the part of the House *that, at the present time, the possibility of tax avoidance in this area is not sufficiently serious to require a special statutory provision.* It is believed that this possibility can be disposed of by judicial decision or by regulation *within the framework of the other provisions of the bill.* [Emphasis added.]

Therefore, even though the liquidation-reincorporation device "had been sanctioned by certain courts under existing law," the Congress expressly refused to overrule those decisions and directed that such an issue be disposed of, if at all, within the framework of the new statutory provisions.

Simultaneously with the deletion of proposed Section 357, present Sections 354, 355 and 368 of the Internal Revenue Code of 1954 were proposed. Code Section 368(a), which replaced proposed Section 359, delineated those transactions which would qualify as reorganizations. The arithmetic requirement of the deleted Section 357, that 50 percent of the assets other than money, stock and securities be transferred, was replaced by the provision in Section 354(b)(1)(A) that the transferee corporation acquire "substantially all the assets" of the transferor. Section 355 provided the rule for taxing distributions to shareholders pursuant to "D" type separations just as Section 354(b)(1)(A) provided them for "D" type liquidation-reincorporations.

The present Code, as rewritten by the Senate Committee on Finance, clearly indicates that the term "sub-

stantially all". contemplates and requires that the acquiring corporation acquire at least 80 percent of all the assets of the transferring corporation. This is made manifest in the following provisions of Section 368-(a)(2)(B) of the 1954 Code:

> (B) ADDITIONAL CONSIDERATION IN CERTAIN PARAGRAPH (1) (C) CASES. —If —
>
> (i) one corporation acquires *substantially all of the properties* of another corporation,
>
> (ii) the acquisition would qualify under paragraph (1)(C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and
>
> (iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1)(C), *property of the other corporation having a fair market value which is at least 80 per cent of the fair market value of all of the property* of the other corporation,
>
> then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1)(C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property. [Emphasis added.]

The above-quoted provision was explained by the Senate Finance Committee as follows:[15]

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[15]S. Rep. No. 1622, 83rd Cong., 2d Sess. 274-275 (3 U.S.C., Cong. & Adm. News (1954) 4629, 4913).

Paragraph (2)(B) provides that where one corporation acquires substantially all the property of another (subsection (a)(1)(C)) if at least 80 percent of the fair market value of all the property of the other corporation is acquired solely for voting stock, *the remainder of the property acquired may be acquired for cash or other property* without disqualifying the transaction as a reorganization. For this purpose only, a liability assumed or to which the property is subject is considered other property. For example, Corporation A has assets worth $100,000 and $10,000 in liabilities. Corporation Y acquires $98,000 worth of assets subject to a liability of $10,000. In exchange for these assets, corporation Y transfers its own voting stock, assumes the $10,000 liability and pays $8,000 cash. This transaction is a reorganization even though a part of the assets of corporation A is acquired for cash. On the other hand, if the assets of Corporation A, worth $100,000, were subject to $50,000 in liabilities, an acquisition of all of the assets subject to the liabilities could only be in exchange for voting stock because the liabilities alone are in excess of 20 percent of the fair market value of the property. Thus, only the rule of subsection (a)(1)(C) could be applicable. [Emphasis added.]

It will be noted that the above provisions require that not only one company acquire "substantially all of the properties of another corporation", but also that it acquire solely for stock properties with a fair market value of at least 80 percent of the total fair market

value of all assets. If the term "substantially all" could include less than 80 percent of the fair market value of all the properties, subsection (i) would be surplusage and of no effect. Obviously, Congress intended it as a limitation in addition to that provided in subsection (iii). To give subsection (i) proper recognition, it must be interpreted as requiring more than 80 percent of the fair market value of all the property. Otherwise, there would be no "remainder of the property" to be covered by cash or other property. This shows clearly that the term "substantially all" requires the acquisition of at least 80 percent of the fair market value of all the assets of the other corporation.

On February 12, 1959, Chairman Mills of the House Ways and Means Committee introduced a bill which proposed certain amendments to the Internal Revenue Code of 1954 with respect to corporate distributions and adjustments. H.R. 4459, 86 Cong., 1st Sess. (1959) (the so-called "Mills Bill"). Section 26 of that bill proposed several changes in the reorganization sections including the deletion of the "substantially all" requirement in "D" reorganizations. H.R. 4459 was in a large part based on the *Report of Working Views of a Study by the American Law Institute Staff and American Bar Association Section of Taxation Liaison Committee.*[16] The reasons why there was thought to be

[16]ALI, FEDERAL INCOME, ESTATE AND GIFT TAX PROJECT, INCOME TAX PROBLEMS OF CORPORATIONS AND SHAREHOLDERS (1958).

a need to change the requirements of a "D" reorganization were summarized in that Report by Stanley S. Surrey, Chief Reporter, as follows (*Ib.*, fn. 16, at 38-39):

> The present "D" reorganization category does not have any statutory continuity of interest requirements regarding the consideration given up, since the focus here is on the control possessed by the transferor side. Hence if continuity of interest rules are prescribed for unifying reorganizations, an added strain is imposed on "D" reorganizations since a taxpayer may seek to use that category to circumvent those rules. In view of this difficulty and of the overlap with section 351, it would be appropriate to consider whether the "D" reorganization category could be eliminated.
>
> It would appear that the "D" reorganization is not needed so far as taxpayers are concerned, in that the tax-free transactions which it encompasses may be carried out under other provisions, including section 351. However, from the Government's point of view the "D" reorganization category if properly framed could be an important weapon against the tax avoidance that would otherwise be possible under various forms of transactions grouped under the phrase "reincorporations." These transactions are in form complete liquidations but in essence involve situations akin to distributions in reorganization or in partial liquidation. Thus, a corporation may form a subsidiary with some of its assets and then in liquidation distribute the stock of the subsidiary along with the remaining assets, so that the shareholders end

up with some assets still in corporate form and the other assets in their individual hands. Or there may be a complete liquidation followed by a reincorporation of part of the assets, thus producing the same result. In these reincorporation transactions the taxpayers are essentially seeking capital gain treatment for the assets retained in shareholder ownership and sometimes a step-up in basis for the assets remaining in corporate form. The Government thus needs some statutory framework to provide appropriate dividend treatment and carryover of basis results for these situations.

The ALI 1954 Draft met the "reincorporation" problem by directly denying complete liquidation treatment to certain enumerated liquidations which were coupled with prior or subsequent transfers to a controlled corporation and providing specific rules for these transactions apart from the reorganization sections. Under the 1954 Code it was presumably intended to meet this problem through the reorganization sections but a statutory framework adequate to that approach was not provided in the Code. The choice between the two solutions is not a significant one, as either can be made effective. The important point is to provide a structural statutory framework which will permit the Service and the courts to cope with these transactions.

H.R. 4459 was never enacted into law. Thus, on two separate occcasions—in 1954 and again in 1959—Congress has failed to codify a measure dealing with liquidation-reincorporations. Therefore, it is patent from the above review of the statute and legislative history

that even where a liquidation and reincorporation have occurred, there will not have been a statutory reorganization if there has not been a transfer of at least 80 percent of the assets of the transferor, for otherwise the "substantially all" requirement of Section 354(b)-(1)(A) will not have been satisfied.

6. The foregoing has demonstrated that the legislative history, the cases, and the administrative rulings which concern the statutory language in issue have all established a quantitative as opposed to a qualitative test for determining whether "substantially all" the assets have been transferred. Therefore, it becomes a matter of weighing those assets which were transferred to Engineers against those assets which were distributed to and retained by Inc.'s shareholders. It, however, is first necessary to consider the unfounded assertions of the courts below[17] that the most valuable assets of Inc.'s business were its reputation and its pool of experienced employees, items which, of course, would have been represented by any good will which Inc. might have possessed. Essentially, because of the nature of the business, Mr. Moffatt and Mr. Nichol were the most valuable employees and their reputation was the business' reputation. Neither the officers nor the employees had any employment contracts, and any one could have retired whenever he wished.

The situation herein is similar to that considered in *D. K. MacDonald,* 3 T.C. 721 (1944), *acq.* 1944 Cum.

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[17]This portion of the Tax Court's opinion will be found at I-R. 170-171, 196-197, and of the Court of Appeals at App. B, p. 17, fn. 2.

Bull. 18, where the Tax Court, in holding that no good will was transferred even though all the employees went with the new company, stated (at 727-728):

> The facts in the instant cases established that any value which this business may have had on July 31, 1941, in addition to its tangible assets, was due to the personal ability, acquaintanceship, and other individualistic qualities of D. K. MacDonald. As one witness put it, "Mr. MacDonald was the Company." The policy of the corporation was decided by D. K. MacDonald and all employees worked under his direction and supervision. There existed no contract between the corporation and any of its employees, including D. K. MacDonald, with respect to future services. Neither the name of the corporation, its location, its agency agreements, nor its existing policies with customers had any value. If the law prevents the recognition of the personal ability and personality of D. K. MacDonald as an element of this corporation's good will for income tax purposes, then petitioners did not receive any good will as a result of their acquisition of this corporation's assets.
>
> We find no authority which holds that an individual's personal ability is part of the assets of a corporation by which he is employed where, as in the instant cases, the corporation does not have a right by contract or otherwise to the future services of that individual. * * *

Accord: Northwestern Steel & Iron Corp. 6 B.T.A. 119 (1927); *Howard B. Lawton,* 6 T.C. 1093, 1100

(1946), *reversed on another issue,* 164 F.2d 380 (6th Cir. 1947), *acq.* 1946-2 Cum. Bull. 3. *And See Robert T. Barber,* 22 CCH Tax Ct. Mem. 1025, 1031-1032 (1963). Similarly, Judge Hastee in his dissent in *Commissioner v. Morgan,* 288 F.2d 676 (3rd Cir. 1960), *cert. denied,* 368 U.S. 836, recognized that the reemployment of the same employees is not a transfer of assets, when he stated (at 682):

> Of course, the reemployment of employees of the liquidating company by the transferee company, which the majority emphasizes, is not a transfer of assets and does not increase corporate worth.

Regardless of whether any good will might have been transferred, it is manifest that before any such good will may become relevant as a transferred asset, a valuation must necessarily be placed thereon in order for it to be weighed in considering whether "substantially all" the assets have been transferred. It will be noted that neither of the courts below nor the respondent have attempted to place any dollar value on that "most valuable asset." *In fact, no such value could have been so assigned herein because the parties entered into the following written stipulation* [*I-R. 120*] *which provides:*

> 21. In the deficiency notices, the respondent has determined in the alternative, that Moffatt and Nichol, Inc. distributed to the individual petitioners in 1959 goodwill with a fair market value of $180,000. It is stipulated and agreed that Moffatt and Nichol, Inc. did not distribute to the individual petitioners, directly or indirectly, any goodwill which had any fair market value. * * *

Accordingly, we are clearly herein concerned only with the tangible assets which were actually distributed. The real test must thus be whether Engineers, in the end, had acquired substantially all of the tangible assets which Inc. had when the first step in the plan was taken. Although it is our contention that a full analysis of the facts would lead to the conclusion that less than 50 percent of Inc.'s assets were transferred to Engineers,[18] such an analysis must await a brief. In the interim, we are content to rely on the fact recognized by both the courts below, that at most only 64.52 percent of Inc.'s assets was transferred to Engineers.[19] Such a percentage should, under no reasonable interpretation of Section 354(b)(1)(A), be held to be a transfer of "substantially all" the assets of Inc. to Engineers.

7. If, in the present case, the petitioners had sold all their stock in Inc. to an outsider for cash and then had organized a new company to enter into and complete future engineering contracts, the result would have been substantially the same, yet it could hardly be argued that such a sale would have resulted in income at ordinary rates. Yet the respondent has argued throughout this case that the petitioners should be

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[18]Assuming that the loans of December 23, 1959 in the total amount of $55,900, which were treated by the Tax Court as reinvestments in Engineers [I-R. 200], were true loans because they were charges against salary indebtednesses due the petitioners from Engineers, then of the $239,552.67 which was distributed in liquidation of Inc. only $92,655.14 would have been reinvested in Engineers, and, of that amount, $37,800.00 was distributed back to the petitioners by Engineers from the Wardlow Property Account by April 14, 1960.

[19]It is undisputed that of the total assets distributed in the liquidation of Inc., $239,552.67, the land and building plans with a fair market value of $84,995.55 were never transferred to Engineers. [I-R. 200-201; App. B, p. 15.]

charged with ordinary income because, as a result of the transactions in issue, they withdrew Inc.'s earnings and profits, which would have been taxed at ordinary rates if they had been distributed as dividends. This argument, however, ignores the fact that, if there is, within the terms of the statute, a liquidation and not a reorganization, a taxpayer must report his gain as capital gain regardless of the fact that part of that gain may represent earnings and profits. Sections 331 and 1001, Internal Revenue Code of 1954. In other words, the very format of the Code provides different methods of taxing withdrawals of earnings and profits, depending on whether such withdrawals are dividends, redemptions, distributions in partial or complete liquidation, or distributions pursuant to a reorganization. *Joseph C. Gallagher,* 39 T.C. 144 (1962), *Acq. in result only,* 1964-2 Cum. Bull. 5. The method of taxation thus clearly depends upon the statutorily defined category into which the transaction falls rather than upon the source of the distribution.

Congress set up specific standards in enacting the reorganization provisions. While we can understand the respondent's desire to increase the revenues by asserting that the "D" reorganization includes all liquidation-reincorporations, we are obliged to point out that that assertion is contrary to the statutory provisions in issue. In the present situation, the law specifically provides that "substantially all of the assets" must be acquired. To hold that anything less would result in a reorganization would clearly thwart the intention of Congress, for such a holding would ignore the plain, ordinary meaning of those words which may not be done. *Malat v. Riddell,* 383 U.S. 569 (1966).

Congress has refused to promulgate specific provisions which would result in the tax treatment which the respondent and the courts below have applied to the facts of this case. In *Commissioner v. Brown*, 380 U.S. 563 (1965), the Commissioner unsuccessfully made a similar attempt to deny capital gains treatment in certain sales to charities where Congress had refused to amend the law to deny such treatment to those types of sales. There (at 579) this Court said:

> The problems involved in the purchase of a going business by a tax-exempt organization have been considered and dealt with by the Congress. Likewise, it has given its attention to various kinds of transactions involving the payment of the agreed purchase price for property from the future earnings of the property itself. In both situations it has responded, if at all, with precise provisions of narrow application. We consequently deem it wise to "leave to the Congress the fashioning of a rule which, in any event, must have wide ramifications." *American Automobile Assn. v. United States*, 367 U.S. 687, 697, 6 L. Ed 2d 1109, 1115, 81 S. Ct. 1727.

Similarly, in this case any such basic change in the law must come from the Congress which to date has twice refused to make such a change.

CONCLUSION.

The problem here is of fundamental importance, for it affects those sections of the statute, the reorganization sections, which are vital in the conduct of business within our dynamic financial world. The decision of the court below is not only inconsistent with

the statute, prior cases, and the respondent's own rulings, but also will, because of that inconsistency, create confusion in an area which requires reliance upon well-defined legal principles. This confusion will necessarily be compounded because of the construction of the courts below which would render the statute, contrary to the intent of Congress, vague and indefinite with no ascertainable standard. Furthermore, in construing the statute in question the Court of Appeals acted unconstitutionally by promulgating alternative and inconsistent constructions of the applicable standard depending upon the party asserting the standard. The courts have a contrary duty to construe the statute exactly as Congress intended it to be construed so that it will avoid these problems. The definition of "substantially all" should be determined once and for all so all taxpayers will be treated equally by the Commissioner and the courts. We have filed this petition so that this Court will have an opportunity to act, as it has done in the past, to resolve an issue of national importance so that all taxpayers will be treated equally and the Commissioner must proceed in an orderly fashion in compliance with final, decisive resolution of this basic issue.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A.

Internal Revenue Code of 1954:

SEC. 331. GAIN OR LOSS OF SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) GENERAL RULE.—

(1) COMPLETE LIQUIDATIONS.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

(b) NONAPPLICATION OF SECTION 301.—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property in partial or complete liquidation. (26 U.S.C., 1958 Ed., Sec. 331)

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) GENERAL RULE.—

(1) IN GENERAL.— No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(2) LIMITATION.—Paragraph (1) shall not apply if—

(A) the principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) any such securities are received and no such securities are surrendered.

(3) CROSS REFERENCE.—

For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) EXCEPTION.—

(1) IN GENERAL.—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

(2) CROSS REFERENCE.—

For special rules for certain exchanges in pursuance of plans of reorganization within the meaning of section 368 (a) (1) (D), see section 355.

* * *

(26 U.S.C. 1958 Ed., Sec. 354)

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN ON EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) TREATMENT AS DIVIDEND.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

* * *

(26 U.S.C. 1958 Ed., Sec. 356)

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term "reorganization" means—

* * *

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

* * *

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

(A) REORGANIZATIONS DESCRIBED IN BOTH (1) (C) AND PARAGRAPH (1) (D).—If a trans-

action is described in both paragraph (1) (C) and paragraph (1) (D), then, for purposes of this subchapter, such transaction shall be treated as described only in paragraph (1) (D).

(B) ADDITIONAL CONSIDERATION IN CERTAIN PARAGRAPH (1) (C) CASES.—If—

(i) one corporation acquires substantially all of the properties of another corporation,

(ii) the acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property.

* * *

(26 U.S.C. 1958 Ed., Sec. 368)

APPENDIX B.

On Petitions for Review of the Decisions of the Tax Court of the United States.

United States Court of Appeals for the Ninth Circuit.

John G. Moffatt, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 19,674.

Mary E. Moffatt, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 19,675.

John G. Moffatt and Mary E. Moffatt, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,676.

Frank E. Nichol, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 19,677.

Ruth H. Nichol, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 19,678.

Frank E. Nichol and Ruth H. Nichol, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,679.

George C. Murray and Anna Mae Murray, Petitioners, vs. Commissioner of Internal Revenue, Respondent. No. 19,680.

Before: BARNES and KOELSCH, Circuit Judges, and CRAIG, District Judge

BARNES, Circuit Judge:

These consolidated cases appear before us on a petition to review decisions of the Tax Court. (42 T.C. 558 (1964).) The Tax Court upheld the Commissioner's assessment of deficiencies in taxpayers' federal income tax returns for the taxable years 1958 and 1959. Our jurisdiction to entertain this petition is con-

ferred by Sections 7482 and 7483 of the Internal Revenue Code of 1954.

One basic question involving the corporate tax provisions of the Internal Revenue Code of 1954 is presented for our consideration. We must determine whether distributions by the corporation, Moffatt & Nichol, Inc., to its shareholders (petitioners) were liquidating distributions under Sections 331(a)(2) and 346, and therefore taxable as capital gains, or were distributions incident to a plan of reorganization under Sections 354 and 368, and therefore taxable as dividends under Section 356. Taxpayers challenge the decision of the Tax Court on the grounds (1) that the steps taken to liquidate Moffatt & Nichol, Inc. were not part of an integrated plan of reorganization, and (2) that the steps taken, even if viewed as interrelated, did not satisfy the statutory reorganization requirements of Sections 354 and 368.

From the date of its incorporation in 1947 until approximately October 1957, Moffatt & Nichol, Inc. was primarily engaged in consulting engineering. Its principal place of business was located in Long Beach, California. During those years the company's stock was owned by taxpayers John G. Moffatt (45%), Frank E. Nichol (45%) and George G. Murray (10%). In addition to its principal activity, the company (hereinafter sometimes referred to as "Inc.") also participated in various joint ventures and was licensed as a building contractor, although it did not actually engage in any building activities. Although the shareholders were Inc.'s key employees, more than sixty other people were employed, about one-third of whom were considered of professional standing. The company prospered greatly

during this decade, and though its taxable income declined in 1957 from the preceding year's figure, the 1957 income had still more than quadrupled the 1953 figure. Despite its prosperity, however, only one dividend ($30,000 in 1955) had been paid from the company's inception.

On April 12, 1957, Henry E. Howard, a certified public accountant, was engaged by Inc. to review the company's tax problems. Howard attended a conference with Inc.'s counsel on April 30, 1957, and afterwards prepared a memorandum concerning those tax matters discussed. This memorandum read in part as follows:

"May 6, 1957

Introductory Statement

At the conference held in your office Tuesday last, certain proposals were discussed relating to the tax problems of the above corporation and its principal stockholders. Several tentative solutions were set forth. Briefly: [1] Liquidation of the corporation. [2] Sale by principal shareholders of a portion of their holdings. [3] Purchase of real estate by stockholders and subsequent sales. [4] Tax planning for existing corporation. . . . [6] Problems of principal stockholders relating to bad debts loss resulting in capital loss carryovers.

I

Liquidation of Corporation

While we appreciate that this would provide the principal stockholders with the sought-after capital gains, it would present other problems which could very well offset the advantages obtained.

The principal disadvantage would be the amount of taxes required to be paid in the year of liquidation. This corporation is reporting profits on a hybrid-accrual method. If this method is adhered to consistently it is doubtful that a change will be made by the commissioner [I.R.C. 446 [c]], however if the corporation ceases operations and liquidates it is probable that all earned income both recorded and unrecorded will immediately become subject to corporate tax rates and also be subject to liquidating dividends. [Rev. Rul. 1953-255].

* * *

An alternative may be found in the delaying of liquidation with a transfer of operations. Under this plan the existing corporation would remain in existence for a period of time, its only activity being completion of present projects and collection of outstanding accounts. This would be accompanied by the formation of a new organization to take on new contracts. The effect would be to defer the payment of the taxes mentioned before and also to cover the possibility of additional non-business bad debts in the hands of the individuals which may occur in future years. This plan of course would require a division of labor and other costs with the resulting increase of time and cost in record keeping. The period for which liquidation could be delayed would be determined by application of section 531, which would probably be about one year after the plan became effective."

This possible approach to the tax problems of Inc. and its key employees reflected the fact that Moffatt and Nichol had each suffered substantial nonbusiness bad debt losses in 1954, 1956 and 1957, and both anticipated future bad debt losses on outstanding loans to one Powers. The above proposal sought primarily to provide ample capital gains against which the capital losses could be offset.

In substance, the above plan of Howard was adopted by Inc.'s management. A new entity, Moffatt & Nichol, Engineers (hereinafter referred to as Engineers), was incorporated on July 22, 1957, with the same principal place of business as Inc. On October 10, 1957, the stock was authorized to be issued to Moffatt (40%), Nichol (40%), Murray (10%), and 10% to Bobisch, a structural engineer, who for some time had been negotiating to purchase a proprietary interest in the consulting engineering operation. When Bobisch, on March 7, 1958, terminated his employment with Engineers, his ten per cent was bought by and distributed equally to Moffatt and Nichol, giving each the identical share that he possessed in the ownership of Inc. Engineers' stock was not actually issued until September 2, 1958.

Moffatt, Nichol and Murray obtained loans in the aggregate amount of $22,500 from Inc. on their notes, in order to pay for their Engineers stock. Payment for the stock was made on October 1, 1957, by having Inc. issue its check for $22,500 to Engineers. The obligations of Moffatt, Nichol and Murray on their notes were discharged on December 23, 1957, through deductions from their salaries by Engineers which were applied for that purpose.

As a consequence of Engineers formation as of October 1, 1957, all employees of Inc., including all officers, were transferred to the books of Engineers. Inc.'s pending contracts were not assigned to Engineers, but the work in process was delegated to the new company which in turn was duly compensated for its efforts. Engineers operated in the same physical premises that Inc. had used since its inception. It also used the same equipment which, for accounting purposes, it leased from Inc. at the depreciation rate plus ten per cent. All new contracts entered into after October 1, 1957, were undertaken in Engineers' name.

The findings of the Tax Court, supported by the evidence in the record, summarize the effects of this transformation:

> "Subsequent to October 1, 1957, Moffatt and Nichol, Inc. had no paid employees, no equipment, and no facilities for conducting an engineering business. Moffatt and Nichol, Inc. had made available to Engineers all of the equipment and facilities necessary to carry on the engineering business it had previously conducted. Its assets consisted, in addition, of cash and liquid items (including accounts receivable), land and building plans relating to such land. Cash necessary for the operation of the consulting engineering business was made available to Engineers by means of loans, and accounts receivable were ultimately transferred to Engineers, all as hereinafter set forth. The land, hereinafter described, had never in fact been used in the business.
>
> "Moffatt and Nichol, Inc. had to remain in existence after October 1, 1957, in order to 'phase

> out' outstanding Government contracts in its hands at that time. These contracts were nonassignable. The primary activity of Moffatt and Nichol, Inc., subsequent to the October 1957 transfer, was the collection of accounts in respect of contracts in its name for which work had been done by it (prior to the transfer) and by Engineers (subsequent to the transfer)." (Tr. 169-70.)

Subsequent to the transfer of the engineering operations to Engineers, loans in the amount of $89,000 were made to Engineers by Inc. Finally, on December 23, 1958, Inc.'s board of directors drafted a formal resolution to wind up its company's affairs. In this regard, Inc. distributed to its shareholders promissory notes, cash, automobiles, office furniture, and other equipment. On January 2, 1960, Engineers purchased the notes and the equipment (with the single exception of one automobile) from the taxpayers. Much of the cash was also transferred by the stockholders to Engineers in exchange for notes.

As a result of this series of transactions, Moffatt and Nichol each reported long-term capital gain in respect of liquidating dividends of Inc. totaling $88,-162.89 for the taxable years 1958 and 1959. Substantial capital losses were offset by each taxpayer against these reported gains. The Tax Court, however, held that the distributions in liquidation by Inc. were "boot" incident to a corporate reorganization (§368(a)(1)(D)), and as such were taxable as ordinary income under Section 356 of the Internal Revenue Code of 1954.

From the above statement of facts, as found by the Tax Court, we find the Tax Court correct in its con-

clusion that the individual steps taken, beginning with the formation of Engineers, were interrelated parts of an integrated plan of reorganization. The proposal contained in the Howard memorandum, adopted with only minor deviation, unquestionably sought to continue the corporate operations, while siphoning off substantial earnings at capital gains rates. The net effect of the steps taken was merely to change the name of the corporation. Inc. remained in existence, for all practical purposes, for the sole purpose of collecting the amounts due on pending contracts which were delegated to Engineers for completion. The evidence thus clearly supports the finding of one integrated transformation.

There remains for our consideration, however, the question of whether the interrelated steps described above constitute a plan of reorganization within the purview of Section 368 of the Internal Revenue Code. It was the determination of the Tax Court that this integrated plan qualified as a reorganization under subsection "D" of Section 368. This provision reads as follows:

"SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) *Reorganization.*—

(1) *In general.*—For purposes of parts I and II and this part, the term 'reorganization' means—

* * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who

were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356 . . . ."

Section 368(a)(1)(E), as a prerequisite to its own operation, requires qualification under an additional statutory provision. In this case, the relevant provision is Section 354, which reads in pertinent part as follows:

"SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) *General Rule.*—

(1) *In general.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, *exchanged solely for stock or securities* in such corporation or in another corporation a party to the reorganization.

* * *

(b) *Exception.*—

(1) *In general.*—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) the corporation to which the assets are transferred acquires *substantially all of the assets* of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are *distributed in pursuance of the plan of reorganization.*" (Emphasis added.)

The findings alluded to above clearly disclose that the transactions in question were pursuant to an integrated plan and did involve an exchange of stock for stock. This leaves as the only Section 354 requirement that must be met for the transaction to qualify as a type "D" reorganization under Section 368 that the new corporation acquired "substantially all" of the assets of the old corporation.

The taxpayers in the present case strenuously contend that not substantially all of Inc.'s assets were transferred to Engineers, and a 368(a)(1)(D) reorganization therefore did not occur. The taxpayers rely primarily on the fact that a large portion of the book assets of Inc. (35.48%) was in the form of land investment and building plans (held for a proposed building construction) which never came into the ownership of Engineers. We find substance to taxpayers' contention when we apply a straight percentage of book assets test to determine what constitutes "substantially all." *Commissioner v. First Nat'l Bank,* 104 F.2d 865 (3d Cir. 1939), is frequently cited for the proposition that 86 per cent total net worth is "substantially all." *Arctic Ice Machine Co. v. Commissioner,* 23 B.T.A. 1223 (1931), similarly is cited for the proposition that 68 per cent is insufficient.

We are of the opinion, however, that a sounder view is espoused by Rev. Rul. 57-518, 1957-2 C.B. 253,

to the effect that no particular or specific percentage should be controlling.[1] Rather, the ruling advises that "the nature of the properties retained by the transferor, the purpose of retention, and the amount thereof" are all to be considered. In the present case the Tax Court made the following finding which we deem dispositive of taxpayers' contention when viewed in the light of the more flexible rule:

> "In one form or another the new company had the use and benefit of all the assets relating to the operation of the business, whether by 'loans', 'rentals' of equipment followed ultimately by sale thereof, or otherwise. And it finally wound up with all the assets that were necessary or appropriate to the conduct of the business. There remained in the hands of the stockholders only certain non-operating assets that were not required in the business, and even these assets [as resources] were 'pledged' [Tr. 171; Ex. PP] by Moffatt and Nichol, Inc. to the new corporation." (Tr. 197-98.)

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[1]That a mechanical result based on pure percentage is not controlling is evidenced by case law.

In *Commissioner of Internal Revenue v. First Nat. Bank of Altoona, Pa.*, 104 F.2d 865 (3rd Cir. 1939), 86% was held "substantially all" of the assets. In *Western Industries Co. v. Helvering*, 82 F.2d 461 (D.C. Cir. 1936), 85.2% was held not to be!

Neither *Pillar Rock Packing Co. v. Commissioner of Internal Revenue*, 90 F.2d 949 (9th Cir. 1937), nor *C.T. Inv. Co. v. Commissioner of Internal Revenue*, 88 F.2d 582 (8th Cir. 1937), compel a different result. *C. T. Inv. Co., supra*, is a weak holding at best, for it was an alternative holding and the court noted that the point was not raised or considered before the Tax Courts. Both cases involved a situation where the *taxpayer* had to show a "transfer of substantially all" assets in order to *avoid* tax. Thus a different standard of construction applies than here, where "capital gains provisions are an exception to the ordinary treatment accorded most income [and must therefore] be strictly construed." *Pridemark, Inc. v. Commissioner of Internal Revenue*, 345 F.2d 35, 44 (4th Cir. 1965).

In the setting of a service organization such as a consulting engineering operation, the retention of physical non-operating assets such as land should not cloud the fact that the essential tangible and intangible assets of one corporation have been transferred to another corporation.[2] That is what occurred here. The skilled employees, the most essential asset of any service organization, were all transferred to Engineers. Similarly, almost the entire lot of operating assets was also transferred. We would ignore the real character and substance of a transaction to hold in this case, as the petitioners urge, that the retention of a substantial portion of the company's dollar assets, unnecessary and unused in the business, is sufficient to defeat the operation of Section 368(a)(1)(D) without making any further inquiry as to the nature of those retained assets and the purpose behind their retention.

In support of affirmance the Commissioner contends the same result is reached by application of 26 U.S.C. §368(a)(1)(F) which applies whenever there is a

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[2]The business of Incorporated—consulting engineering—was a service business and its most valuable asset consisted of its reputation and the pool of experienced employees which passed intact to Engineers. This asset carried no balance sheet value but plainly constituted a real item of considerable value to Incorporated. Merely because no precise value may be ascribed to this intangible does not, in our estimation, preclude it from a consideration as an asset. Where a business is largely service oriented, as here, this item may well be the single most valuable asset. It is no answer that the employees could resign, as the taxpayers argue. Common experience shows that employees seldom resign en masse. Indeed one of the most fertile areas of controversy today when there is a proposal of merger or other change in business is job loss and tenure "rights" of employees. The finding by the Tax Court is supported by the testimony of Hatteberg, quoted in taxpayer's brief at page 52, and no reason is suggested why this finding should be disregarded.

"mere change in identity, form, or place of organization, however effective."

Considering these additional factors, and dispensing with the solitary and technical percentage theory, we find, in accordance with the position taken by the Tax Court, that Inc. transferred *substantially* all of its assets to Engineers. We therefore find that the transactions in question did constitute a type "D" reorganization.

The decisions of the Tax Court are affirmed.

DISSENTING OPINION

CRAIG, Distict Judge.

The majority opinion well states the issues before this Court. Based upon the record in this case, I would disagree with the conclusion of the majority opinion that the steps taken to liquidate Moffatt and Nichol, Inc. constituted a part of an integrated plan of reorganization.[1]

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[1]Petitioners, John G. Moffatt, Frank E. Nichol and George G. Murray, were the sole stockholders of Moffatt and Nichol, Inc. Inc. was organized in 1947, and its primary business was the practice of consulting engineering; it was also licensed, however, as a building contractor and engaged in some large-scale speculative joint ventures in that endeavor.

On July 22, 1957, Moffatt and Nichol, Engineers, was incorporated. Messrs. Moffatt, Nichol and Murray became officers in the new company, while retaining the same officer positions in Inc. There was one new stockholder, W. J. Bobisch, who purchased ten per cent of the stock in the new company. The new company's activities were restricted to consulting engineering work, thus avoiding the inherent risk involved in speculative joint ventures. The old company, Inc., continued negotiations for joint venture operations as it had in the past. Inc. retained all of its existing engineering contracts, but arranged for the remaining work to be performed by Engineers

The real issue in this case seems to me to be the interpretation of Section 354(b)(1)(A). Assuming, however, that the majority is correct in its conclusion that there was in fact an integrated plan of reorganization, the transaction in my opinion would still not qualify under the provisions of Section 368(a)(1)(E) be-

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as its agent. There is disagreement as to the purpose of the organization of Engineers. The Commissioner contended, and the majority opinion upholds that contention, that it was a part of an over-all plan to reorganize Inc. The Petitioners, on the other hand, contended that there was no intent to reorganize, for the new corporation was formed in order that certain key employees, including Bobish, could invest in a company which did not engage in construction or joint ventures.

Until December 23, 1958, both corporations carried on operations. Most of Inc.'s activity involved speculation on certain joint ventures and the purchase of land for a new building. On December 23, 1958, Inc. adopted a resolution to dissolve. The subjective reason for this dissolution is, of course, in dispute. The commissioner contends that it was merely another step in a planned reorganization. The petitioners claim that the large losses being sustained by Engineers, coupled with the passage by Congress on August 28, 1958, of Internal Revenue Code §§1371-1377, triggered the decision. The petitioners would thus have assets to invest in the new corporation, and upon electing to be taxed as a partnership, they could deduct the losses attributable to Engineers on their individual returns.

There are three requirements which must be met for a transaction to qualify as a corporation reorganization under Sections 354 and 368(a)(1)(D):

(1) The corporation to which assets were transferred must acquire "substantially all of the assets" of the transferor corporation.

(2) There must be a plan of reorganization.

(3) The stockholders must exchange stock in the old company for stock in the new.

The contention of the Commissioner that there was a planned reorganization is apparently based upon two circumstances: First a new accounting firm was employed by Inc. in April of 1957 to examine the records of Inc. as of December 31, 1956. (T.R. Vol. II, p. 26.) One of the partners of the firm, a Mr. Henry Howard, attended a conference with Inc.'s counsel, a Mr. Kennedy, at which several subjects were discussed, including the tax problems of Inc. At the request of Mr. Kennedy, Mr. Howard prepared a memorandum for Mr. Kennedy,

(This footnote is continued on the next page)

cause of the effect of Section 354, which is, as the majority opinion states, a prerequisite to the operation of Section 368(a)(1)(E). Section 354(b)(1)(A) requires that the corporation to which the assets are transferred acquire *substantially all of the assets* of the transferor of such assets before the transaction qualifies under Section 368, supra.

The total liquidation to the petitioner stockholders was $239,522.67, which may be itemized as follows:

	(Fair Market Value)
December 1958—Notes of the new corporation due to the old	$ 40,000.00
December 1959—Money	60,000.00
December 1959—Automobiles and equipment	10,169.93
December 1959—Accounts Receivable	20,303.25
December 1959—Land and building plans	84,995.85
January 1960—Money	24,183.64
	$239,522.67

setting forth a number of recommendations. (Exhibit No. MM.) The record does not disclose that the contents of the memorandum were communicated to the principals or anyone other than Mr. Kennedy. To the contrary, there is testimony that the contents of the memorandum were not communicated to the principals of Inc. or Engineers by anyone. The record does not disclose any action by the Board of Directors of either Inc. or Engineers upon the contents of the memorandum. Second, the dissolution and liquidation of Inc. in December, 1958, over a year and a half after submission of the memorandum, and subsequent to the passage by Congress in August of 1958 of IRC §§1371-1377; some of the activities of Inc. in December, 1958, and subsequently, had been suggested in the memorandum of May, 1957, from Mr. Howard to Mr. Kennedy. The lapse of time, the activities of the parties, the economic conditions as they affected the two corporations, all as disclosed in the record, seem to dispel the idea of a "plan of reorganization".

Of these amounts it is not seriously disputed that the land and building plans worth $84,995.85 have not been transferred to the new company, nor is it contested that the following definitely were transferred:

Notes of the new corporation due the old	$ 40,000.00
Automobiles and equipment	9,772.33
Accounts receivable	18,799.17
	$ 68,571.50

The Commissioner contended that much of the cash was technically transferred to the new company, since the petitioners made some large loans to Engineers after receiving cash from Inc.'s liquidation.

The Commissioner first contends that "substantially all of the assets" means "substantially all of the operative assets". I cannot agree. If Congress intended to limit the transfer to "operative assets" it would have said so. Congress did not, and the Court should not read into the Code that which is not there. *Pillar Rock Packing Company v. Commissioner,* 9 Cir., 90 F.2d 949 (1937); *C. T. Inv. Co. v. Commissioner,* 88 F.2d 582 (1937).

Petitioners cite numerous cases which indicate that "substantially all of the properties" under the 1939 Code was interpreted as meaning at least 80% if not more of the properties, including intangibles such as accounts receivable. *Pillar Rock Packing Company v. Commissioner,* supra; *Western Industries Co. v. Helvering,* 82 F. 2d 461 (1936); *Schuh Trading Co. v. Commissioner,* 95 F.2d 404 (1938); *National Bank of Commerce of Norfolk v. U.S.A.,* 158 F.Supp. 887

(1958). In *Halliburton v. Commissioner,* 9 Cir., 78 F.2d 265 (1935), the Court held that the term "property" in the tax law includes "money", unless otherwise expressly provided by Congress. There is no way of knowing precisely why Congress adopted the new terminology of "assets" over the old "properties", but the effect was certainly not to narrow the scope of the phrase. Therefore, were the Court to conclude, and it should not, that the building and the land were the only assets which were not transferred to the new company, this would constitute a transfer of only 64.52% of the assets, which is not "substantially all of the assets." It is not necessary to decide where the demarcation line of "substantially all" may lie, but it should be held that it is certainly somewhere above 64.52%.[2]

In appraising the evidence as to whether there was a "substantial transfer", the respondent seeks to place a value on "intangibles", which may also be described as "good will". This suggestion arises from the nature of Engineers' business.

The record discloses the fact to be that at no time in the operation of either company was "good will" considered to be an asset, nor was any value placed thereon. Moreover, this Court should be foreclosed from considering this factor in determining the value of the assets transferred. (T.R. Vol. II, pg. 12, line 24 through pg. 13, line 4.)

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[2]For a discussion of the meaning of "substantially all" see *Dudderar v. Commissioner,* 44 T.C. 58, where it was held that the words "substantially all" as used in Section 264(b)(1) must be given their ordinary meaning of all but a small negligible amount.

While Congress may be presumed to have exercised its taxing power to the fullest, that presumption does not authorize this Court to supply additional language to the act. Moreover, if we were to disregard the record in this case and assign a "thin air" value to good will, or intangibles, or whatever name may be applied, even to the extent of $180,000.00, we would still have under 80% of the assets transferred.

It has been suggested that a loan should be treated as a "transfer of assets" within the meaning of the statute. The two terms are wholly and completely incompatible. A transfer of assets under any interpretation denotes an investment without the attendant risks. A loan carries with it an obligation to repay with a fixed rate of interest. We must take the record as we find it, and in this case the record does not support the defense that there was a transfer of "substantially all of the assets" as required in order to tax as ordinary income.

The Respondent contends that an historical analysis of Congressional action produces the startling conclusion that Congress intended "substantially all" in Section 354 to mean 50%. This conclusion is reached by inferring that a proposed Section 357 (H.R. 8300), which was never enacted, was incorporated in Section 354. This is unrealistic and untenable. If Congress says "substantially all", it means just that, and not 50%.

It is my opinion, therefore, that substantially all of the assets were not transferred from Inc. to Engineers, and this transaction does not qualify as a corporate reorganization under Section 354 and Section 368(a)(1)(D). Under the circumstances of these cases, it is not

necessary to determine whether there was a plan of reorganization or whether an exchange of stock from the old company to the new was made.

The Commissioner claims, however, that at any rate Section 368(a)(1)(F) should apply. That section would define reorganization as: "A mere change in identity, form, or place of organization, however effected".

The cases under consideration do not fall within the purview of this section, for, as has been noted, there was more than a "mere change". The new company did not do any contracting or engage in joint ventures. There was a new shareholder who did not own stock in Inc., and Engineers did not acquire some of the major assets which Inc. possessed. See: *Joseph C. Gallagher,* 39 T.C. 144, at 161, 162. Section (F) seems the complement of Section (D) to the extent that finding, as we should, there was not a transfer of substantially all of the assets, we could not then say there was a "mere change in identity or form."

The Commissioner finally contend that if there was no reorganization under Sections 354 and 368, then the amounts involved were still corporate dividends under Section 301, and were not received in liquidation of a corporation. The specific governs over the general and Sections 331(a)(2) and 346 are directly applicable here.

Finally, it seems to me that the majority opinion abrogates the judicial function in the interpretation of "substantially all" when it judicially approves the interpretation "espoused by Rev. Rul. 57-518, 1957-2 C.B. 253". It seems to me that this phase of the majority opinion goes a step beyond judicial legislation. In ef-

fect it gives a judicial blessing to the arrogation, by a branch of the Executive Department, of the legislative process. If Congress had intended "substantially all" to mean what the Internal Revenue Department thinks it means, it would have said so. I would hold that the Tax Court erred and that its finding was contrary to the weight of the evidence. It is my opinion that the transaction involved here was a liquidation under Sections 331(a)(2) and 346 of the Internal Revenue Code of 1954. The amounts received by Petitioners represented distributions in partial liquidation, taxable under Sections 331 and 346, supra, as capital gains, and should be treated as such. It is my opinion that for the reasons stated the decisions of the Tax Court in these cases should be reversed.

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 804

JOHN G. MOFFATT, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court are reported at 42 T.C. 558. The opinion of the court of appeals is reported at 363 F. 2d 262. The order denying the taxpayers' petition for rehearing *en banc* is not officially reported.

JURISDICTION

The judgments of the court of appeals were entered on May 31, 1966, and rehearing was denied on August

29, 1966. The petition for a writ of certiorari was filed on November 28, 1966. The jurisdiction of this court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the transfer of all the operating assets of a corporation to a new corporation constituted a transfer of "substantially all of the assets of the transferor" within the meaning of § 354(b)(1)(A) of the Internal Revenue Code of 1954, so that the transaction was a corporate reorganization and the shareholders were taxable as a dividend on the non-operating assets distributed to them.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 are set forth in the Appendix, *infra*, pp. 13-15.

STATEMENT

The facts are fully set forth in the Tax Court's opinion (R. 155-203);[1] in summary, they are as follows:

Moffatt & Nichol, Inc. ("M & N") was engaged in the business of consulting engineering in Long Beach, California. Its stock was owned by petitioners John G. Moffatt (45 percent), Frank E. Nichol (45 percent), and George G. Murray (10 percent).

[1] "R." references are to the printed record in the court of appeals.

Two of the three petitioners had sustained capital losses and wished to realize a capital gain against which to apply the losses. (Pet. App. 7, 10.)

In July, 1957, petitioners formed a new corporation, Moffatt & Nichol Engineers ("Engineers"). Petitioners borrowed $22,500 from M & N which they paid to Engineers for 90 percent of its capital stock. Ten percent of Engineers' stock was owned by a third party (an employee) for a short period of time; thereafter the stock ownership of Engineers was identical to that of M & N. In October, 1957, M & N's employees and business were transferred to Engineers. M & N loaned substantial sums of money to Engineers in return for the latter's notes. Thereafter M & N retained, in addition to the notes receivable from Engineers, certain accounts receivable, some cash, and a parcel of vacant land worth approximately $85,000 which was not related to its former engineering business (plus building plans relating to the land). (Pet. App. 10-12; R. 174-176.)

In December, 1958, M & N's board of directors voted to dissolve the corporation, and M & N distributed to petitioners (its stockholders) the following: $40,000 of promissory notes due from Engineers; $84,083 in cash; automobiles and other equipment worth $10,169; accounts receivable worth $20,303; and the vacant land (plus building plans) worth $85,000. Petitioners then transferred the cash, accounts receivable, and equipment to Engineers in return for additional notes receivable (Pet. App. 12; R. 176).

The Commissioner of Internal Revenue determined that the distributions from M & N to petitioners (less the amount paid to Engineers for stock purchased by them) were taxable as dividend distributions rather than as distributions in liquidation (R. 12, 28, 41, 57, 72, 85, 105). This determination was sustained by the Tax Court (Pet. App. 6), which was in turn affirmed by the court of appeals (Pet. App. 6-18). Both lower courts concluded that the series of steps here in question constituted a corporate reorganization within the terms of § 368(a)(1)(D) of the 1954 Code and that the property and notes received by petitioners constituted "boot," taxable as ordinary income under Code § 356(a)(2) (Pet. App. 15-18).

Petitioners now concede for purposes of this case that the transaction contained every element of a "D" reorganization except one, *i.e.*, they deny that "substantially all of the assets" of M & N were transferred to Engineers as required by Code § 354(b)(1) (Pet. 13-14). Thus, the sole question presented is whether substantially all M & N's assets were transferred to Engineers.

ARGUMENT

The decision below was correct, and there is no conflict of decisions or other reason for review by this Court.

1(a). In general, if substantially all the assets of a corporation (here M & N) are transferred to a new corporation (here Engineers) which is controlled by

the transferor corporation or its stockholders, the transaction constitutes a "D" reorganization. 1954 Code § 368(a)(1)(D), 354(b). If the transferor corporation (M & N) then liquidates and distributes retained assets (the vacant real estate) to its stockholders (petitioners) this property constitutes "boot" and is taxed as a dividend if it "has the effect of the distribution of a dividend." Code § 356(a)(2).

The theory behind this treatment is as follows: If M & N has distributed the vacant land while retaining its operating assets intact, the stockholders (petitioners) would have been taxed as a dividend on the value of the distributed property. If M & N transferred all of its operating assets to a new corporation (Engineers), which was essentially a continuation of M & N, and also distributed the vacant land to its stockholders, the distribution of the land should result in a dividend tax, just as if the transfer from one corporation to the other had not taken place.

The Code accomplishes this result by taxing as a dividend property ("boot") distributed to shareholders incident to a reorganization. Petitioners argue, however, that, even though M & N's business continued uninterrupted in the new corporate shell (Engineers), the instant transaction nevertheless does not constitute a reorganization and that they should be allowed to withdraw part of M & N's undistributed profits—in the form of the vacant land and notes—at the capital gains rate.[2] Petitioners contend that

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[2] If the transaction does not constitute a reorganization, 1954 Code § 331 dealing with complete liquidations would apparently make petitioners' profit on the transaction a capi-

because the nonoperating assets withdrawn from the corporation constituted 35 percent of the total assets (both operating and nonoperating), "substantially all of [M & N's] assets" were not transferred to Engineers as required by § 354(b)(1)(A).

(b) In a number of cases arising under the Internal Revenue Code of 1939, taxpayers had argued that similar transactions of this nature were not reorganizations with the attendant dividend tax on the "boot" distributed; rather, they argued that despite the continuation of the business by the new corporation, the transaction should be taxed as a complete liquidation with a resulting capital gain tax. The courts, however, have rejected these arguments and held that whenever the essential business enterprise is transferred to a new corporation which is controlled by the transferor corporation's stockholders, the transaction constitutes a "D" reorganization and the "boot" is taxable as a dividend. See, *e.g.*, *Liddon* v. *Commissioner*, 230 F. 2d 304 (C.A. 6), certiorari denied, 352 U.S. 824; *Pebble Springs Distill. Co.* v. *Commissioner*, 231 F. 2d 288 (C.A. 7), certiorari denied, 352 U.S. 836; *Lewis* v. *Commissioner*, 176 F. 2d 646 (C.A. 1); *Becher* v. *Commissioner*, 221 F. 2d 252 (C.A. 2).

(c) Although Congress revised some of the relevant reorganization sections when it enacted the 1954

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tal gain. If, on the other hand, the transaction is a reorganization, § 331 would be inapplicable and § 356(a) would tax the "boot" as a dividend if it "has the effect of the distribution of a dividend."

Code, we believe that the statutory language, the legislative history, and the pertinent policy considerations demonstrate that enactment of the 1954 Code did not change the rule that existed under the 1939 Code.

Before 1954 the "D" reorganization provision had included two discrete types of transactions: *First*, the divisive reorganization in which a single corporation is split into two separate corporations, and *second*, the reincorporation reorganization in which the operating assets of an existing corporation are transferred to a new corporation controlled by the same shareholders and the original corporation is liquidated.[3]

In enacting the 1954 Code Congress provided separate treatment for these two types of "D" reorganizations. Congress intended divisive "D" reorganizations to be controlled by § 355, while reincorporation "D" reorganizations would be covered by § 354(b)(1). The statutory mechanics for accomplishing this dichotomy were to make § 354(b)(1) applicable only if the original corporation had transferred "substantially all of [its] assets" to a single new corporation and liquidated; and to channel all other "D" reorganizations into § 355.

The legislative history demonstrates that these changes were designed to insure that no divisive reorganization could circumvent the strict new require-

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[3] A variation of this form is the unifying reorganization whereby the assets of two commonly controlled corporations are transferred to a single corporation.

ments of § 355, but were not intended to change the existing rules for reincorporation-type "D" reorganizations, such as the one here in question. The House bill had proposed a new statutory formula (proposed § 357) which was designed to provide stringent limitations on the use of reincorporation-type "D" reorganizations. See H. Rep. No. 1337, 83d Cong., 2d Sess., pp. A129-A134. The Senate rejected this proposed § 357 which would have changed the rules applicable to reincorporation reorganizations, and stated that its new § 354(b)(1) would impose "the same [rules] as under existing law." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 265. The House receded from its position, expressing the view that "the possibility of tax avoidance in this area * * * can appropriately be disposed of by judicial decision or by regulation within the framework of the other provisions of the bill." H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., p. 41.

(d). The effect of the instant transaction is that virtually all of M & N's operating assets were transferred to Engineers, and the vacant land which had never been used in M & N's business was distributed to the stockholders. Petitioners now concede that this would constitute a "D" reorganization and the distribution of the vacant land would constitute a dividend if substantially all of M & N's assets had been transferred to Engineers. However, petitioners argue that since the vacant land constituted 35 percent of M & N's total assets by value, less than substantially all of its assets were transferred to Engineers. If petitioners are correct, § 354(b)(1)(A) would con-

stitute a broad avenue of tax avoidance; any corporation which had a substantial amount of cash, liquid assets or investments could distribute them to its stockholders at the capital gain rate by merely coupling the distribution with a transfer of its operating assets to a newly-formed corporation and a liquidation of the old corporation. It is clear that Congress, in enacting the 1954 Code, did not intend to overrule the 1939 Code cases and create such a loophole. Thus, both lower courts properly employed a qualitative rather than a quantitative approach to the phrase "substantially all" and correctly concluded that when a corporation transfers all of its operating assets to a new corporation, and distributes nonoperating assets to stockholders, there has been a transfer to the new corporation of "substantially all of the assets" within the meaning of § 354(b)(1).[4]

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[4] In deciding that the words "substantially all of the assets" in § 354(b)(1)(A) did not require a mechanical percentage test, the court of appeals volunteered that it agreed with Rev. Rul. 57-518, 1957-2 Cum. Bull. 253, which said that the language "substantially all of the properties" in § 368(a)(1)(C) requires consideration of such elements as the nature of the property retained, the purpose of retention and the amount thereof (Pet. App. 15-16). And in a footnote the court of appeals sought to reconcile this position with *Pillar Rock Packing Co.* v. *Commissioner*, 90 F. 2d 949 (C.A. 9), where it had apparently taken a contrary view on the § 368(a)(1)(C) language (Pet. App. 16). Petitioners attack this attempted reconciliation (Pet. 16-19). However, we do not believe it necessary to consider the correctness of the Ninth Circuit's 30-year old opinion dealing with a "C" reorganization and the language of § 368(a)(1)(C) in the instant case dealing with a "D" reorganization and the language of § 354(b)(1)(A).

2. Both the Fifth and Tenth Circuits have recently indicated their agreement with a qualitative approach to 1954 Code § 354(b)(1)(A). See *Reef Corp.* v. *Commissioner*, 368 F. 2d 125, 131 (C.A. 5), affirming 24 TCM 379, 395, petition for certiorari pending No. 1005, this Term; *Babcock* v. *Phillips*, decided January 27, 1967 (C.A. 10); see also *Davant* v. *Commissioner*, 366 F. 2d 874, 884-887 (C.A. 5), petition for certiorari pending No. 911, this Term. These cases indicate that the "substantially all" requirement is met where virtually all of the operating assets are transferred to a new corporation, even though large amounts of liquid assets are distributed to stockholders. The Tenth Circuit emphasized that a reincorporation-type "D" reorganization is present when the new corporation is merely "a reincarnation" of the old, "the [old corporation's] business [is continued by the new] as a going concern," and the old corporation's stockholders are "not disassociated from the new corporation." *Babcock* v. *Phillips*, *supra*. The Fifth Circuit commented that "a study of the complete legislative history of section 368(a)(1)(D) clearly shows that when Congress added the second section in 1954, it was attempting to close old loopholes, not create new ones." *Davant* v. *Commissioner*, *supra*, p. 886, fn. 25. This flexible, qualitative approach to § 354(b)(1)(A)'s requirement of "substantially all" has been described in a leading text as "the sounder view that no particular percentage is controlling." Bittker and Eustice, *Federal Income*

Taxation of Corporations and Shareholders (1966 ed.), p. 526.[5]

---

[5] Despite the absence of a conflict petitioners ask this Court to review this case in order to give the tax bar a broad definition of the terms used in § 354(b)(1)(A). However, this Court has expressly refused to lay down general rules with respect to the tax-free reorganization provisions, because of the danger that it would open them to tax avoidance schemes . See, *e.g.*, *Bazley* v. *Commissioner*, 331 U.S. 737, 741. Moreover, the Commissioner has sought to give some guidance as to the type of transactions to which he would grant favorable rulings. In Rev. Proc. 66-34, 1966-34 Int. Rev. Bull. 22, he states that although he is not attempting to define the statutory terms, he will "ordinarily" in granting advance rulings regard the "substantially all" requirement in § 354 (b)(1)(A) as satisfied if there is a transfer of 90 percent of the net assets or 70 percent of the gross assets held immediately prior to the transfer. Rev. Proc. 66-34 accomodates the need of the tax bar for some guide lines in the preparation of requests for rulings while also preserving the Commisioner's freedom of action in those cases where the percentage rules which "ordinarily" apply are not appropriate, *e.g.*, in situations like the instant case, where nonoperating assets have been held back for what is in substance a dividend distribution to shareholders.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEBRUARY 1967.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

* * * *

(b) *Exception.*

(1) *In General.*—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) the stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

* * * *

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) *Gain on Exchanges.*—

(1) *Recognition of Gain.*

If—

(A) section 354 or 355 would apply to an exchange but for the fact that

(B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) *Treatment as Dividend.* If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

* * * *

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) *Reorganization.*

(1) *In General.* For purposes of parts I and II and this part, the term "reorganization" means—

* * * *

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but

only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

* * * *

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SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

October Term, 1966
No. 804

JOHN G. MOFFATT, *et al.*,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief in Reply to Respondent's Brief in Opposition.

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IN THE

Supreme Court of the United States

October Term, 1966
No. 804

JOHN G. MOFFATT, *et al.*,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Brief in Reply to Respondent's Brief in Opposition.

The facts, law and reasons for issuing a writ of certiorari in these actions have been set forth and discussed in the Petition for Certiorari filed herein. There, however, are certain errors, inconsistencies, and irrelevancies upon which the respondent has predicated some of his arguments in his Brief in Opposition which require response.

1. The cited cases of *Liddon v. Commissioner,* 230 F. 2d 304 (6th Cir. 1956), certiorari denied, 352 U.S. 824; *Pebble Springs Distill. Co. v. Commissioner,* 231 F. 2d 288 (7th Cir. 1956), certiorari denied, 352 U.S. 836; *Lewis v. Commissioner,* 176 F. 2d 646 (1st Cir. 1949); *Becher v. Commissioner,* 221 Fed. 252 (2nd Cir. 1955), are not in point. Each of those cases found

that there was a "D" reorganization under the Internal Revenue Code of 1939, but the pertinent statutory language in those cases required only that there be a transfer of "all *or a part*" of the transferor's assets. §112(g)(1), Internal Revenue Code of 1939. In fact, in *Lewis v. Commissioner, supra,* the court said (at 949): "Nor does the statute make the amount of property transferred to the new corporation a decisive factor in determining whether a reorganization took place." See also, *Pebble Springs Distill. Co. v. Commissioner, supra,* at 282. In the instant cases, however, the pertinent statutory language requires a transfer of "substantially all" of the transferor's assets, for Congress has substituted these quoted words in a "D" reorganization under Sections 368(a)(1)(D) and 354(b)(1)(A) of the Internal Revenue Code of 1954 in lieu of the less restrictive words "all or a part" which were found in the 1939 Code; thus the cited cases are of no precedent in the instant actions which involve distinctly different statutory language.

2. The respondent has stated (Br. 11, fn. 5) that the petitioners ask this Court to review this case despite the absence of a conflict in the decisions and then goes on to state that this Court has expressly refused to lay down general rules with respect to the tax-free reorganization provisions. *Bazley v. Commissioner,* 331 U.S. 737, is cited as authority for the latter proposition. Although we have pointed out that there is a conflict (Pet. 14), there need be no such conflict for this Court to consider a corporate reorganization issue, for in *Bazley* itself this Court did not address itself to any such conflict but granted certiorari because the corporate reorganization question there was of "importance to the

Treasury as well as to corporate enterprise.'"[1] Id., at 739. Indeed, both of the cases which were decided in that opinion had been resolved in favor of the Government in the courts below. Additionally, this Court in the *Bazley* case did lay down the general rule that the word "recapitalization" as used in the "E" reorganization must be broadly construed, and, since that decision was handed down, it has served as a guide to the taxpayers, the Commissioner, and the courts. Likewise, as has been demonstrated in our Petition, the need for a decision with respect to the breadth of the statutory words in issue herein is equally needed in the corporate reorganization area of the revenue laws.

3. Nor does Rev. Proc. 66-34, 1966-34 Int. Rev. Bull. 22, contrary to the assertions of the respondent (Br. 11, fn. 5), establish any guidance with respect to this type of transaction. The Commissioner has indicated therein that he will "*ordinarily*" regard the "substantially all" requirements of both Sections 368(a)(1)-(C) and 354(b)(1)(A) as having been satisfied if at least 90% of the net assets and 70% of the gross assets have been transferred, but by use of the word "*ordinarily*" he has reserved freedom of action to withhold a favorable ruling even where those requirements have been met. This reservation, however, applies only to those situations where those requirements *have been met*. The implication is therefore patent—a favorable ruling will not be given in any case where those requirements *have not been met*. *See* Pet. 21-24.

4. The respondent's indecisive method of distinguishing the long-standing case of *Pillar Rock Paving*

[1]The importance of the present issue to the Treasury (Pet. 29-31) and to the corporate public (Pet. 10, fn. 5) has been well recognized.

Co. v. Commissioner, 90 F. 2d 949 (9th Cir. 1937), by stating that that case involved a "C" reorganization is clearly without merit. *See* Pet. 13, fn. 9. Even Rev. Proc. 66-34, *supra,* which the respondent claims gives guidance in this area, employs the same test in a "C" reorganization as in a "D" reorganization under Section 354(b)(1)(A).

5. The respondent has also cited (Br. 10) the recent cases of *Babcock v. Phillips,* CCH 1967 STAND. FED. TAX REP. (67-1 U.S. Tax. Cas.) Par. 9236 (10th Cir. 1967) and *Reef Corp. v. Commissioner,* 368 F. 2d 125 (5th Cir. 1966), as authority for his position, but these cases are clearly distinguishable from the instant case.[2] In *Babcock v. Phillips,* the old corporation transferred $3,827,254.76 to the new corporation and distributed to its stockholders additional assets in the amount of $506,388.80 together with certain other assets which were evidently of such a small amount that the Court found it unnecessary to value them; thus, in value, approximately 88% of its assets was transferred by the old corporation to the new corporation, whereas, in the instant actions, at most, only 64.52% of the old corporation's assets were transferred to the new corporation. In *Reef Corp. v. Commissioner,* the transferor corporation borrowed cash which it distributed to its stockholders. The taxpayer there argued that, because the cash was so distributed, "substantially all" of the assets of the old corporation had not been transferred to the new corporation. The Fifth Circuit answered that argu-

[2]The respondent also made a passing reference (Br. 10) to *Davant v. Commissioner,* 366 F. 2d 874 (5th Cir. 1966) but the court in that case did not even refer to the "substantially all" question, and there is no indication that the taxpayer therein raised such an issue.

ment by stating (at 131): "However, eliminating this cash, approximately eighty percent of the assets of Reef Fields were transferred to new Reef and this is a sufficient basis for the finding by the Tax Court". But, in the instant actions, there was no such contrived increase in the assets by taking a loan or in any other manner, and less than 80% of the assets—at most, only 64.52% —was transferred. We fail to see where holdings that transfers of approximately 88% and 80%, respectively, were transfers of "substantially all" the assets within the meaning of the statutory language are in any way inconsistent with the petitioners' position herein or support the respondent's position in any manner.

Conclusion.

For the reasons given above and in our Petition, we respectfully submit that a writ of certiorari should be granted.

Respectfully submitted,

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